GOVERNMENT OF INDIA

MINISTRY OF COMMERCE

REPORT OF THE INDIAN TARIFF BOARD

ON THE

WORKS COST OF HOT METAL (IRON FOR STEEL-MAKING) AND FAIR EX-WORKS PRICES OF PIG IRON (BASIC AND FOUNDRY GRADES)

BOMBAY

1949

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REPORT ON THE WORKS COST OF HOT METAL (IRON FOR STEEL MAKING) AND FAIR EX-WORKS PRICES OF PIG IRON (BASIC AND FOUNDRY GRADES).

Pig iron prices.

1. Pig iron prices have not been statutorily controlled. During the war, however, Government made half-yearly contracts with the Tata Iron and Steel Company and the Indian Iron and Steel Company for supplies of pig iron for war purposes at special Government rates. These special rates were in force upto 31st March, 1946. Since 1st April, 1946, supplies to Government have been made on the basis of commercial prices. On 1st February, 1948, the commercial prices were increased by Rs. 20 per ton over the previous rates. Government wanted to examine the reasonableness of this increase and deputed their Cost Accounts Officer to examine the works cost of pig iron at the works of the Indian Iron and Steel Company. The Company could not agree to the costs as arrived at by the Cost Accounts Officer, nor could it accept the overheads and profits as suggested by the Ministry of Industry and Supply. Subsequently, it was decided to refer the whole question to the Tariff Board for detailed investigation.

Reference to the Board : Scope of the inquiry.

2. The Government of India, Ministry of Commerce, in their letter No. 3-T/(1)/48, dated 15th October, 1948, (Appendix I), requested the Board to investigate the works cost of hot metal (iron for steel making) and also determine the fair ex-works prices for pig iron (basic and foundry grades), while determining the fair retention prices for billets and other categories of steel as desired in Government's Resolution No. 3-T/(1)/48, dated 7th February, 1948.

Method of inquiry.

3. The Board's Technical Adviser and Cost Accounts Officer visited the Works of the Indian Iron and Steel Company at Hirapur and Kulti on 26th October, 1948, and examined the works costs for the period April/June, 1948, in the case of the Kulti Works and January/March, 1948, in the case of the Hirapur Works, as these periods were considered to be normal from the point of view of production. With these costs as the basis, they worked out the estimates of works costs for the year 1949. These were shown to the management of the Company and agreed to by it. It may be pointed out that at the Hirapur Works of the Indian Iron and Steel Company, no distinction is made in the costs between hot metal (iron for steel making) supplied to the Steel Corporation of Bengal and the cost of pig iron (basic and foundry grades) available for sale. Since, however, the consumption of raw materials and production per day differs considerably for hot metal and foundry iron, we have estimated the costs separately for hot metal and for foundry iron on the basis of the information supplied by the Company. We are not recommending separate prices for pig iron (basic and foundry grades) produced at the Works of the Tata Iron and Steel Company, as the production of pig iron there is incidental and forms a fraction of the Company's total production of hot metal. We have, however, examined the hot metal cost and

pig casting machine cost at the Tata Iron and Steel Company's Works in connection with our inquiry into the fair retention prices for steel. The representatives of the Indian Iron and Steel Company were examined by the Board on 7th and 8th December, 1948, and the names of those who attended the inquiry are given in Appendix II.

Estimate of production.

4. (*a*) The normal rated capacity at the Hirapur Works is 5,00,000 tons per annum and at the Kulti Works it is 2,50,000 tons per annum. On account of coke shortage, however, production at both the works is below capacity. As a matter of fact, one blast-furnace is completely shut down at Kulti. The Company expects to step up production as soon as its new coke oven plant, which is under construction, is ready.

(*b*) After discussion with the management of the Company, we have estimated the annual production for the year 1949 at the Hirapur Works at 4,40,000 tons and at the Kulti Works at 1,26,000 tons. Out of 4,40,000 tons at the Hirapur Works, 2,64,000 tons will be supplied to the Steel Corporation of Bengal as hot metal (steel-making iron), and the balance of 1,76,000 tons consisting of pig iron (foundry grades) will be available for sale. At Kulti, out of the estimated total production of 1,26,000 tons, 15,000 tons will be high silicon pig iron which will be used in their own foundries. In addition to this, 72,000 tons of other foundry grades iron will also be required at the Kulti Works. Only 39,000 tons of various foundry grades will be available for sale. Thus, out of the total estimated production of 5,66,000 tons per annum at Hirapur and Kulti, the balance of 2,15,000 tons will be available for sale.

Works costs.

5. (*a*) The following statement gives the works costs of hot metal (steel making iron) at the Works of the Tata Company and at the Hirapur and Kulti works of the Indian Iron and Steel Company, the works costs of basic-grade pig iron at the Works of the Tata Company and at the Hirapur Works of the Indian Iron and Steel Company, and also the works costs of foundry grade pig iron at the Hirapur and Kulti works of the Indian Iron and Steel Company :—

	Tata Company	Indian Iron and Steel Company	
		Hirapur Works	Kulti Works
	Rs. per ton.	Rs. per ton.	Rs. per ton.
Hot metal (steel making)	46·36	62·45	
Pig iron (basic grade)	55·80	64·62	
Pig iron (foundry grades)	..	70·99	71·18
Weighted average cost of pig iron (foundry grades) at Hirapur and Kulti		71·06	

(*b*) *Hot metal.*—It will be seen from the above statement that the cost of hot metal (steel-making iron) at the Hirapur Works of the Indian Iron and Steel Company is higher than that at the Works of the Tata Company by Rs. 16·09 per ton. The following statement gives the break-up of the works costs of hot metal into net material cost and above net material cost (operating cost):

Items of cost.	Tata Company's Works	Indian Iron and Steel Company's Hirapur Works.
	Rs. per ton.	Rs. per ton.
Materials	41·23	52·05
Credits	6·35	6·29
Net material cost	34·88	45·76
' Above net material cost ' (operating cost)	11·48	16·69
Total works cost	46·36	62·45

(*i*) *Material cost.*—The higher material cost at the Hirapur Works of the Indian Iron and Steel Company is due to the higher rate at which the Company gets its iron ore, coke and limestone. The consumption of coke and limestone also is higher than at the Works of the Tata Company. The larger consumption of coke and limestone was discussed with the Company's representatives and the explanation given by them was that the quality of the coke which the Company had been using had deteriorated considerably and that, as soon as its new coke ovens came into operation, its consumption of coke and limestone would come down appreciably. The reason for the higher cost of iron ore is the higher freight on account of the longer distance over which the ore has to be brought in the case of the Indian Iron and Steel Company. In respect of limestone also, the basic cost as well as the freight are higher than the rates at which the Tata Company obtains it.

(*ii*) *Operating cost.*—The total operating cost at the Hirapur Works of the Indian Iron and Steel Company is also higher than that of the Tata Company by Rs. 5·21 per ton. This higher operating cost is the cumulative effect of higher costs of various items, such as steam, services and general works expenses.

(*c*) *Pig iron* (*basic grade*).—The works costs of basic-grade pig iron at the Works of the Tata Company and at the Works of the Indian Iron and Steel Company have been arrived at by adding the pig-casting machine expenses to the cost of hot metal. The comparative works cost of basic-grade pig iron are given below :—

	Tata Company	Indian Iron and Steel Company.
	Rs. per ton.	Rs. per ton.
Cost of hot metal	46·36	62·45
Pig-casting machine expenses	9·44	2·17
Total works cost	55·80	64·62

The pig-casting machine expense at the Works of the Tata Company is higher than that of the Indian Iron and Steel Company by Rs. 7·27. The higher expense is mainly due to the lower output of basic-grade pig iron, the production of which at the works of the Tata Company is only incidental.

(*d*) *Pig iron* (*foundry-grades*).—The Tata Company is not producing pig iron (foundry-grades) in any appreciable quantity for sale, and we have not estimated the works costs of foundry-grade pig iron at the works of this Company. The weighted average cost of foundry-grade pig iron at the works of the Indian Iron and Steel Company at Hirapur and Kulti are given below :—

	Production per annum.	Rate per ton
	Tons.	Rs.
Hirapur	1,76,000	70·99
Kulti	1,11,000	71·18
Total production and weighted average cost per ton.	2,87,000	71·06

These works costs represent the average cost of all grades except basic-grade and other special irons. The figure of Rs. 71·06 per ton may be taken as the works cost of grade II. The works cost of grade I would be slightly higher than this and that of grade III would be lower. The difference in the costs of various grades is due to slight variations in the quantities of raw materials used and in operating costs. We have not gone into these details. We, however, consider that the present difference of Rs. 2 between the prices of grades I and II, grades II and III, and grades III and IV, is reasonable. This differential is agreed to by the Company. Accordingly, the average works cost arrived at by us, *viz.*, Rs. 71·06 may be taken to represent the works cost of grade II and the works costs of grade I and grade III may be taken to be Rs. 73·06 and Rs. 69·06 respectively.

6. (*a*) Having determined the works costs, we have now to examine the overheads and profits. Under this heading, we propose to include depreciation, working capital, and a reasonable return to provide for managing agency commission, taxation and dividends. Of these, we propose to relate depreciation and return to the gross value of the block, and we, therefore, proceed to determine the value of the block of the works at Hirapur and at Kulti.

Overheads and profits.

(*b*) The gross value of the block at Hirapur as on 31st March, 1948, according to the published accounts of the Company, was Rs. 582 lakhs. The Works at Kulti previously belonged to the Bengal Iron Company, and the Indian Iron and Steel Company took it over in 1936. The gross value of the block at Kulti on 31st March, 1948, was Rs. 218 lakhs, which included blocks relating to pipe foundry, brass foundry, spun pipe foundry and collieries. The Company pointed out that this value as given in the books of the Company did not give a

correct picture of the capital value of its plant and machinery, as the value was written down at the time of the amalgamation of the Bengal Iron Company with the Indian Iron and Steel Company. In assessing the gross value of the block at Kulti for pig iron production, we have, therefore, first to estimate the total value of the gross block and then deduct from it the value of block relating to pipe foundry, brass foundry, spun pipe foundry and collieries. This was not an easy matter. The Company submitted half a dozen estimates on different bases and finally suggested that the value of the block at Hirapur and Kulti together might be taken at Rs. 8 crores. We carefully examined these estimates and discussed them with the management of the Company. The only course which appeared to us to be practicable was to estimate the value of the block at Kulti on the basis of tonnage of production in the same ratio as the value of the block to the tonnage of production at the Hirapur Works. At Hirapur, the value of the block, as pointed out earlier, is Rs. 582 lakhs. Of this, over a crore of rupees was spent on block for supply of services like power, gas, water and steam to the Steel Corporation of Bengal at the time of its inception and which, strictly speaking, did not form a part of the block for the production of pig iron. If we deduct this, the block for the production of pig iron at Hirapur comes to Rs. 482 lakhs. The estimated production of pig iron at Hirapur is 4,40,000 tons per annum. That means that the value of the block employed for a ton of production at Hirapur, works out to Rs. 109·5. If we apply this value of block per ton of production to the estimated production of 1,26,000 tons at Kulti, the value of the block at Kulti will be Rs. 138 lakhs. The gross value of the block at Hirapur (Rs. 582 lakhs) and Kulti (Rs. 138 lakhs) together will be Rs. 720 lakhs. We have not deducted Rs. 1 crore from the Hirapur block for the plant and machinery employed for services to the Steel Corporation of Bengal, but we propose to make a deduction in the total overheads for the realizations over cost from the Steel Corporation in respect of the supply of services.

(c) *Depreciation.*—The Company has asked for depreciation at a flat rate of 5 per cent. On Rs. 8 crores, or Rs. 40 lakhs per annum. At present, the income-tax authorities allow the Company about Rs. 30 lakhs per annum and the Company will, therefore, be liable to income-tax on the additional Rs. 10 lakhs. In order to leave a net allowance of Rs. 40 lakhs, the Company has suggested that the total allowance for depreciation should be Rs. 47 lakhs. The sum of Rs. 30 lakhs, which the income-tax authorities allow at present, includes depreciation for the block relating to pipe foundry, brass foundry, spun pipe foundry, and collieries. If a reduction is made on this account, the amount of depreciation that is being allowed on plant and machinery employed for pig iron production will be still less. Besides, we have not agreed to the value of the block at Rs. 8 crores as the Company has suggested. But, according to the new rules of depreciation announced for a three-shift working, the Company will be entitled to a higher depreciation than what it actually obtains at present. Taking all these factors into consideration, we allow Rs. 30 lakhs per annum for depreciation.

(d) *Working capital.*—The Company has asked for an allowance of Rs. 12 lakhs per annum as interest on a working capital Rs. 3 crores at 4 per cent.

We have discussed with the representatives of the Company the principal items of expenditure constituting the working capital and found the Company's claim for Rs. 3 crores on the high side. We consider Rs. 2 crores for working capital as reasonable and allow 4 per cent. interest on it, which amounts to Rs. 8 lakhs.

(e) *Return on block.*—The Company has claimed Rs. 64 lakhs as profits, Rs. 6 lakhs as managing agency commission, and Rs. 5·51 as profit-sharing bonus. The total amount claimed under these three heads comes to Rs. 75·51 lakhs. To cover these items, we consider a return of 8 per cent. on a block of Rs. 7·2 crores as reasonable, and we allow Rs. 58 lakhs.

(f) *Head office and selling expenses.*—The Company has not claimed anything under this head, as these expenses are already taken into account in the works costs.

(g) The following satatement gives the Company's claim in respect of overheads and profits and the amount we have allowed :—

Items	Amount claimed by the Company.	Amount estimated by the Board.
	Lakhs of Rupees.	Lakhs of Rupees.
OVERHEADS—		
Depreciation	47	30
Interest on working capital	12	8
Head office expenses	..	
MANUFACTURERS' PROFIT, MANAGING AGENTS' COMMISSION, AND PROFIT-SHARING BONUS.	75·51	58
Total ..	134·51	96

This estimate of Rs. 96 lakhs for overheads and profits inculdes surplus realisations over works cost in respect of services and supplies to the Steel Corporation and the sale of sulphuric acid. On these two counts, we propose to make a deduction of Rs. 10 lakhs, thus reducing the estimate of overheads and profits for hot metal and pig iron to Rs. 86 lakhs. Overheads and profits on hot metal are, however, governed by the IISCO-SCOB Agreement. Under this Agreement, for the supply of hot metal the Indian Iron and Steel Company will realise from the Steel Corporation about Rs. 17 lakhs as depreciation, debenture interest and surcharge at 5 per cent. on works cost. Besides this, the Company will also realise about Rs. 12 lakhs as its share of the Steel Corporation's profits. Thus, the total overheads and profits that the Company will be getting for hot metal supplied to the Steel Corporation will amount to about Rs. 29 lakhs. If we deduct this amount from Rs. 86 lakhs, we get Rs. 57 lakhs as overheads and profits on pig iron available for sale. We propose to distribute this amount of Rs. 57 lakhs on a production of 3,36,000 ton

(that is, 6,00,000 tons as suggested by the Company *minus* 2,64,000 tons sold as hot metal). The overheads and profits on pig iron will then work out to Rs. 17 per ton (in round figure).

Fair retention prices, ex-works.

7. The following statement gives the works costs of pig iron, basic and foundry grades, overheads and profits, and fair ex-works retention prices :—

(1)	(2)	(3)	(4)
	Works costs.	Overheads and profits.	Ex-works fair retention price.
	Rs. per ton.	Rs. per ton.	Rs. per ton.
Basic grade	64·62	17	82
Foundry grade I	73·06	17	90
Foundry Grade II	71·06	17	88
Foundry Grade III	69·06	17	86
Foundry Grade IV	67·06	17	84

We recommend fair retention prices, ex-works, as given in column (4) of the above statement.

Future costs.

8. (*a*) During the course of our inquiry, we were informed by the Company that, to avoid the present difficulties of supply of limestone, the Company is negotiating with another firm for the supply of limestone and the rates quoted by the new Company are considerably higher. In our works costs we have not taken this in to account, as the Company had not finalised its contract with the new suppliers.

(*b*) We have been informed by the Company that during the course of the year its new coke oven battery will come into operation which should reduce its costs appreciably ; and we, therefore, recommend that at the end of a year, costs should be reviewed and fair retention prices adjusted accordingly.

Freight disadvantage.

9. The Company has represented to us that the present system of quoting prices f. o. r. ports and allowing a freight disadvantage on that basis is unfair. It has also furnished us with a statement showing that it incurred a loss of Rs. 8-7-5 per ton during 1947-48 and Rs. 12-9-3 per ton for seven months, April to October, 1948. As the terms of reference to the Board confine this inquiry to determining the fair ex-works retention price, we have not examined this question, but we would suggest that the question of freight disadvantage may be examined by Government at an early date.

10. Our conclusions and recommendations may be summarised as under :—

Summary of conclusions and recommendations.

(1) The works costs are based on an estimated production of 5,66,000 tons. [*Paragraph 4 (b)*].

(2) The works cost of hot metal at the Hirapur works of the Indian Iron and Steel Company is higher than that at the Tata Company's Works by Rs. 16·09 [*Paragraph 5 (b)*].

(3) The weighted average works cost of pig iron (foundry grades) at the works of the Indian Iron and Steel Company is Rs. 71·06. [*Paragraph 5 (c)*].

(4) The rate of overheads and profits is Rs. 17 per ton of saleable pig iron. [*Paragraph 6*].

(5) Fair retention prices for pig iron (basic and foundry grades) should be fixed at rates given in column (4) of the statement in paragraph 7.

(6) As the new coke oven battery of the Company will come into operation during the current year, the costs should be reviewed at the end of a year and fair retention prices adjusted accordingly. [*Paragraph 8 (b)*].

Acknowledgments.

11. Our thanks are due to Mr. R. N. Kapur, Technical Adviser to the Board, and Mr. O. N. Anand, Cost Accounts Officer attached to the Board, who assisted us at every stage of the inquiry.

G. L. MEHTA,
President.

H. L. DEY,
Member.

B. V. NARAYANASWAMY,
Member.

R. DORAISWAMY,
Secretary.

BOMBAY,
18th March, 1949.

APPENDIX I

(*Vide* PARAGRAPH 2)

No. 3-T(1)/48.

GOVERNMENT OF INDIA

MINISTRY OF COMMERCE.

New Delhi, the 15th October, 1948.

FROM

R. Doraiswamy, Esquire,
Under Secretary to the Government of India.

To

The Secretary,
Indian Tariff Board,
Contractor Building, Nicol Road,
Ballard Estate, Bombay.

SUBJECT.—*Investigation by the Tariff Board of the Steel prices.*

SIR,

In continuation of this Ministry's letter No. 3-T(1)/48, dated the 7th January, 1948, on the above subject, I am directed to request that the Board, while determining the fair retention prices for billets and other categories of steel, may kindly investigate the works cost of hot metal (iron for steel-making) and also determine the fair ex-works price for pig iron (basic and foundry grades).

Yours faithfully,

(Sd.) R. DORAISWAMY,

Under Secretary to the Government of India.

APPENDIX II

(*Vide* PARAGRAPH 3)

List of persons who were examined by the Board on the 7th and 8th December, 1948.

(1) Sir Padamji Ginwala (2) Mr. H. V. Peeling (3) Mr. E. G. Leversedge	Representing the Indian Iron and Steel Company, Ltd., Burnpur.

सत्यमेव जयते